16.06 Segment Reporting

Publicly held companies (not non-public or not-for-profit) are required to report certain key information about significant segments of their business, referred to as **reportable segments**. The definition of "segment" is based on a concept known as the **management approach**, in which a segment represents any group of activities with revenues and expenses that is regularly evaluated by management as a single unit.

According to ASC 280, a segment is a component of a public entity that has three characteristics:

- It is involved in business activities that may result in earning revenues and incurring expenses, whether external or internal.
  - External activities involve transactions with other entities.
  - Internal activities involve transactions with other components of the same public entity.
- Its performance is evaluated by management for the purposes of resource allocation.
- Financial information identifiable to the component is available.

Different segments can be in the same line of operations, as long as management evaluates them separately for internal purposes. Segments may be identified, for example, by:

- *Activity*, such as manufacturing components making up one segment and distribution centers, another.
- *Product*, such as those components distributing heavy equipment making up one segment and those distributing software making up another.
- *Customers*, such as those components making sales domestically making up one segment and those selling internationally making up another.

There are three different ways to identify a reportable segment. A segment is reportable if it contributes at least **10% of the total for all segments** of one or more of the following:

- Revenues
- Assets
- Profits

The **revenue** test is based on combined revenues of all segments, including those resulting from intersegment sales. This is the case even though consolidated revenues on the income statement will eliminate intersegment activity.

Assume the client has 4 industry segments with the following revenue information:

Segment	Sales to Unaffiliated Companies (Outside)	Intersegment Sales	Total Sales
A	$20	$25	$45
B	150	45	195
C	35	0	35
D	95	30	125
Total	$300	$100	$400

Although consolidated revenue on the income statement is reported at $300, the 10% test is applied to total sales of $400, so segments with total sales of at least $40 are reportable. Segments A, B, and D are reportable, and C is not.

There is also a 75% test, discussed below, that requires additional reportable segments to be included when the total external revenue reported by segments is less than 75% of total external revenues. That criterion is met in this case—75% of $300 (the unaffiliated revenue = $225). Reportable Segments A, B and D = $265, which is at least 75%.

The 10% test applying to **profits** is the most complex. First, the calculated amount for each segment represents **operating income** only (sales reduced by cost of sales and selling, general, and administrative expenses). Furthermore, expenses incurred at the overall corporate level (such as the salaries of the company's top officers) are excluded from the computations. Common costs, however, must be included and allocated among the various segments, using an appropriate technique (always identified in exam questions).

Assume that the company had total sales of $1,000, of which $300 occurred in Segment C. Segment C had operating expenses of $90. The company as a whole had $200 of common expenses, and allocates common costs based on sales. The operating profit of Segment C is computed as follows:

Sales	$300
Operating expenses	90
Income before common costs	210
Common costs – 200 × (300 / 1,000)	60
Operating profit	$150

All segments having **operating profits** are combined, and all segments having operating losses are combined. The **10% test** is applied to the **higher** of the combined profits or combined losses. In performing this test, absolute values are considered. This means it does not matter if the larger total is the total of the segments with profits or losses. Ten percent of the number represented by the larger total is the threshold. In addition, it does not matter if the segment earned a profit or incurred a loss. If the amount of component's profit or loss is at least equal to the threshold amount, it is a reportable segment.

Let's assume the four industry segments of a business have the following operating income figures:

Segment	Operating Profit (Loss)
A	1,850
B	(190)
C	150
D	(310)

The combined operating profits are $1,850 + $150 = $2,000, and the combined operating losses are $190 + $310 = $500. Since $2,000 is higher, the 10% test requires a segment to have $200 or higher net profit or loss, so that segments A and D are the reportable segments.

The 10% test applied to **assets** includes identifiable assets only, not goodwill. There are no special complications and this is rarely tested.

In addition to reporting significant segments based on the management approach, a public company should also report data for **foreign operations** (geographic areas) if such operations contributed at least 10% of total revenues or total identifiable assets. Reporting of revenues should separately identify sales to unaffiliated customers and intersegment sales.

Finally, a company should report revenues from **major customers**, referring to those that individually provided at least 10% of consolidated revenues.

There must be enough segments separately reported so that at least *75% of unaffiliated revenues (to outsiders)* is shown by reportable segments. If the 75% test is not satisfied, additional segments must be designated as reportable (even if don't meet the three tests) until the test is satisfied.

- Don't exceed 10 reported segments; combine the smaller segments. There is a practical limit to the number of segments reported (ie, reporting too many segments may make information needlessly detailed).
- Report aggregate information for all nonkey segments.
- Not required to disclose allocated costs and expenses of reportable segments.
- An enterprise may consider *aggregating two or more* operating segments if they have similar economic characteristics and if the segments are similar in each of the following areas:
    - Nature of products and services
    - Production process
    - Type of customers
    - Methods used to distribute their products or services
    - Nature of regulatory environment

Disclosure – An enterprise must disclose the following general information:

- General information, including how reportable segments are identified and the types of products and services from which each reportable segment derives its revenues.
- Certain info about the basis of measurement for reported segment profit or loss and segment assets.

  - Internal and external revenues
  - Interest income and expense
  - Depreciation, depletion, and amortization expense and other significant noncash items
  - Unusual items
  - Equity in net income of equity method investees
- Income tax reconciliations of the segment amounts to the enterprise amount, including revenues, profit or loss, and assets
- Interim period information
- Enterprise-wide disclosures
  - External product and service revenue
  - Geographic area revenue including both domestic and foreign revenue.
  - Geographic area Long-lived assets.
  - Information about major customers (> 10% revenue).

Reportable Segment ≥ **10%**

a. **Operations in Different Industries** (test #1,2,3) → Meet any of 3 tests, disclose ALL 3

b. **Foreign Operations** (Geographic areas) (test #1 & 3) → Meet any 1, disclose ALL 3

c. **Major Customer or Export Sales** (test #1) → Meet, disclose ONLY 1

Three Tests

1) **Revenue** = If segment's revenues ≥ 10% of Company's total revenue (includes intercompany/intersegment sales & transfers)
2) **Profit/Loss** = If segment's P/L ≥ 10% of Combined operating Profit/Loss of all segments that had a Profit/Loss.
   - Includes allocated common costs
   - Excludes Corporate level expenses
     - Interest
     - Income taxes
     - Gain/loss from discotinued ops
3) **Segments asset test** = If segments assets ≥ 10% of Company's identifiable assets

75% Test

There must be enough segments separately reported so that at least *75% of unaffiliated revenues (To outsiders)* is shown by reportable segments. If the 75% test is not satisfied, additional segments must be designated as reportable (even if don't meet the 3 tests) until the test is satisfied. NOTE: In the first example, 75% of 300 (the unaffiliated revenue = $225.) Reportable Segments A, B and D = $265, which is at least $225, so the 75% rule is met.